The AES Corporation
Second Quarter 2020 Financial Review
Prepared Remarks

Ahmed Pasha
Treasurer & Vice President, Investor Relations, The AES Corporation

Thank you, operator. Good morning, everyone, and welcome to our second quarter 2020 financial review call. Our press release, presentation and related financial information are available on our website at aes.com.

Today, we will be making forward-looking statements during the call. There are many factors that may cause future results to differ materially from these statements, which are discussed in our most recent 10-K and 10-Q filed with the SEC. Reconciliations between GAAP and non-GAAP financial measures can be found on our website along with the presentation.

Joining me this morning are Andrés Gluski, our President and Chief Executive Officer; Gustavo Pimenta, our Chief Financial Officer; and other senior members of our management team.

With that, I will turn the call over to Andrés. Andrés?

Andrés Gluski
President & Chief Executive Officer, The AES Corporation

Good morning, everyone, and thank you for joining our second quarter financial review call. Today, I'll spend some time on three near term priorities: achieving our 2020 guidance; attaining a second investment grade rating; and decarbonizing our portfolio.

We believe that progress in these three key areas will allow us to reach a larger investor base in the near term. They will also advance our longer-term strategic and financial objectives. After discussing these three themes, I'll provide an update on our sustainable growth initiatives and our efforts to create a technological competitive edge.

Last quarter, I indicated that we were well positioned to withstand the impacts of the COVID-19 pandemic due to the resilience of our business model. I'm pleased to report that our second quarter results demonstrate this resilience, and keep us on track to achieve our full year guidance.

We delivered Adjusted EPS of $0.25 in the second quarter, in line with last year. This reflects the strength of our business model, which is based on long-term take-or-pay contracts with credit-worthy customers. As a result, we are very confident that we will

achieve our 2020 Adjusted EPS guidance of $1.32 to $1.42 and our expected Parent Free Cash Flow of $725 million to $775 million. At the same time, we have continued to grow our free cash flow.

We ended the second quarter with a Parent Free Cash Flow to debt ratio of 24%, which is comfortably above the 20% threshold required for investment grade ratings. As a reminder, we've already received one investment grade rating from Fitch and remain optimistic that we will attain our second investment grade rating later this year.

Turning to our aggressive decarbonization goals on slide 4. As we've said before, we are very focused on reducing our generation from coal to less than 30% of total generation, to comply with Norges Bank environmental investment criteria. On this front, we've made great progress over the past two months, signing binding agreements to sell OPGC in India and Itabo in the Dominican Republic. These sales will reduce our generation from coal by 11 percentage points to 34%. We're working on a couple of additional transactions, that combined with our growth in renewables, will allow us to easily comply with Norges Bank criteria by next year.

To further our reduction in coal exposure, AES Gener is negotiating with several offtakers in Chile to delink PPAs from physical assets and be able to monetize the value of long-term tolling agreements. These transactions will demonstrate that the real value of the business is in its contracts and customers, while providing funding for AES Gener's successful Green Blend and Extend renewables growth strategy.

Turning to slide 5 and sustainable growth. I'm happy to announce that since our last call, we have been awarded or signed 852 megawatts of new renewable PPAs. This brings our year-to-date total to 1.5 gigawatt, including 346 megawatts of energy storage. As a result, our backlog of new renewable projects increased to 6.2 gigawatts. About half of this backlog is in the US and the majority is expected to come online between 2021 and 2024.

Therefore, we remain on track to continue to add 2 gigawatts to 3 gigawatts of new renewables per year by capitalizing on our business platforms and our growing technological expertise. In addition to our 6.2 gigawatt backlog, we have a pipeline of 15 gigawatts of renewable projects under active development in the US. This considerable pipeline positions us very well for an acceleration in US Renewables growth, if federal policies change following the November elections.

Turning to slide 7, we're also consolidating our position in existing renewable platforms. To that end, we recently acquired additional shares of AES Tiete, increasing our ownership from 24% to 43%. We will finance this acquisition mostly through non-recourse debt in Brazil and it is accretive from day one.

We plan to upgrade AES Tiete's listing to Novo Mercado under Bovespa, where companies trade at significant premiums due to best-in-class governance. This move is expected to further unlock the value of AES Tiete for the benefit of all of its

shareholders. We continue to actively pursue new technologies to support our growth in renewables and innovative products that meet the changing needs of our customers.

As you can see on slide 8, Fluence, our joint venture with Siemens that sells energy storage technology to third parties, continues to be the global market leader in this sector. This leadership is based on our track record of deploying more than 2 gigawatts of energy storage, present in 22 countries and offering more than 40 digital applications to our customers.

This year, Fluence's revenue is expected to reach $500 million, an increase of 400% in relation to last year. We believe that energy storage will play a major role in the global transition to a low carbon economy. As a result, we expect Fluence's revenue to grow at 40% compounded annually to reach $3 billion by the end of 2025.

Turning to slide 9, we are already experiencing this acceleration of growth in demand for energy storage. In June, Fluence launched its sixth-generation product, which includes a modular and factory assembled cube design that is safer, more reliable and lower cost. Fluence's new cube already has orders for more than 800 megawatts to be delivered over the next three years.

As you may know, Fluence is currently running a private placement for a minority partner, in order to capitalize this high-growth business. We are encouraged by the strong interest we are seeing from potential investors and we expect to have concrete details to share with you before the end of the year.

Together, AES and Fluence continue to pioneer new applications for lithium-ion-based energy storage technology. One example is a virtual reservoir for run-of-the-river hydropower projects, utilizing energy storage that charges when power prices are low and discharges during peak hours.

As shown on slide 10, at the Cordillera hydro complex in Chile, we just commissioned the world's first such virtual reservoir with 10 megawatts or 50 megawatt hours of energy storage. We can further expand this facility to 250 megawatts or 1,250 megawatt hours over the next couple of years. Today, about half of all our renewable projects have an energy storage component.

Now moving on to slide 11. We continue to pursue new technologies that have the potential to provide us with a competitive advantage in our markets. To that end, we recently acquired a 25% stake in 5B, a prefabricated solar solution company in Australia. With 5B's patented technology, solar projects can be built in a third of the time and in half the space.

We believe that being able to double solar energy output from a given area will become increasingly important as solar penetration increases, especially near urban or congested areas. In addition to 5B's potential pipeline of more than 10 gigawatts of third

party projects in Australia, we see an additional addressable market of 5 gigawatts across our developing pipeline.

As part of this strategic agreement, we have exclusive rights to develop utility scale projects using 5B's technology in our key markets, including the US. We have already started the deployment of 2 megawatts in Panama and 10 megawatts in Chile. We aim to be the most competitive solar developer by using 5B to reduce time-to-build and increase energy density, while combining it with our robotic and digital solar initiatives.

Turning to slide 12. In 2018, AES invested in Uplight to improve our customer experiences by digital cloud-based technology. In addition, Uplight provides cloud-based services to third parties to improve energy efficiency and balance system demand. This fast growing business already reached more than 100 million households and businesses in the US, and expects a 20% increase in annual revenue in 2020.

Finally, regarding our partnership with Google, it is progressing well. And as you might have seen, we recently launched an RFP for 1 gigawatt of carbon free energy in PJM. We are working on several other significant initiatives with Google and we will share additional details as this firm up.

In summary, our ongoing leading technology efforts aim to give us a competitive edge to deliver the products and services required by our customers in a rapidly evolving and growing market.

Now, I would like to turn over the call to Gustavo Pimenta, our CFO, so he can provide more color on our results, debt profile and guidance.

Gustavo Pimenta
Executive Vice President & Chief Financial Officer, The AES Corporation

Thank you, Andrés. Today, I'll cover three key topics: our resilient business model, our performance during the second quarter and our capital allocation plan. Let me start with our resilient business model on slide 14. As you can see, 85% of our earnings are from utilities and long-term contracted generation, with an average contract life of 14 years. This provides significant stability to earnings and cash flow.

We have also reduced our exposure to volatility in foreign currency by growing the portion of our US dollar earnings. As you can see on slide 15, today 85% of our earnings are in US dollars as compared to approximately 60% a few years ago. For context, through 2022, a 10% appreciation of the US dollar would reduce our annualized EPS by only 1.5% or $0.02.

Looking at Latin America specifically, almost all of our businesses in that region are contracted. As you can see on slide 16, nearly 60% of these businesses have no volumetric risk as a result of the take or pay nature of the contracts. The remaining

capacity is mostly contracted with large industrials and export-oriented mining companies that continue to operate despite COVID-19, as they are deemed essential. We intentionally work with high quality offtakers and business strategy is also contributing to the resilience of our business model. For example, as you can see on slide 17, roughly two-thirds of our customers in Latin America have investment grade profiles. The remaining customers are largely backed by government on institutions. The result of this resilient contracting structure and customer base can be seen in our collections performance on slide 18, with Q2 receivables and days sales outstanding remaining very much in line with historical levels.

Moving on to the impact of global lockdowns on our financial results on slide 19. As you may recall, we have anticipated an extended U-shaped recovery in energy demand across our markets. This assumed that second quarter would be the hardest hit with a demand drop of about 10% to 12% at our US utility businesses and between 7% and 15% internationally. The actual result was not as severe as anticipated with volume at our US utilities dropping mid-single digits and demand in other markets declining in the range of low-single digits to low-double digits.

As I have noted, our generation businesses did not experience any material impact on our earnings from lower demand. Our utility business, where most of our volume exposure is, experienced an impact of about $0.02 on Adjusted EPS for the quarter, better than our initial expectation of $0.03 to $0.04. Despite this encouraging result, we continue to assume an extended U-shaped recovery for guidance purpose, given the overall uncertainty around the macro environment.

Now, turning to our quarterly results on slide 20. Adjusted EPS was $0.25 for the quarter versus $0.26 last year. This reflects the lower demand at our regulated utilities I just discussed, and the regulatory changes that were implemented at DPL in Argentina in 2019. We were able to offset these headwinds through higher contributions from our South America and Eurasia SBUs, as well as our cost savings and deleveraging initiatives.

Turning to slide 21. Adjusted Pre-Tax Contribution or PTC was relatively flat at $238 million for the quarter, with a decrease of only $2 million versus the second quarter of 2019. I'll cover our results in more detail over the next four slides, beginning on slide 22.

In the US and Utilities SBU lower PTC reflects the lower regulated tariff implemented in Q4 2019 due to the reversion to ESP 1 rate at DPL, as well as lower demand at Utilities due to the impact of COVID-19. Additionally, at Southland, we had lower capacity revenues as a result of the retirement of some of our legacy units in 2019.

At our South America SBU, higher PTC was primarily driven by higher contributions from AES Gener, including better operating performance at our Guacolda plant and recovery of previously expensed payments from customers in Chile.

Higher PTC at our MCAC SBU reflects improved availability at our Changuinola hydro plant in Panama, following an extended major outage last year. We also benefited from improved hydrology in Panama following a very dry year in 2019. This was partially offset by outage-related insurance proceeds in the Dominican Republic last year.

Finally in Eurasia, high results reflect improved operational performance in Vietnam, and the impact of the sale of our loss making business in the United Kingdom.

Now to slide 26. To summarize our performance in the first half of the year, we earned Adjusted EPS of $0.54 versus $0.53 last year. We are reaffirming our 2020 Adjusted EPS guidance range of $1.32 to $1.42. Relative to the first half of 2020, performance in the second half of the year will benefit from contributions from our new businesses, including the 1.3 gigawatt Southland Repowering project, for which the 20-year contract began in the second quarter and about 1 gigawatt of renewables coming online.

Now turning to our credit profile on slide 27. As we discussed on our first quarter call, since 2011, we reduced our Parent debt by approximately $3 billion or about 50%. At the end of the second quarter, our Parent leverage was 3.5 times and our Parent Free Cash Flow to debt ratio was 24%, comfortably within the investment grade thresholds of 4 times and 20%, respectively. This highlights once more our credit stress and give us confidence in attaining our second investment grade rating later this year.

Moving on to liquidity on slide 28. We have $3.5 billion in available liquidity, two-thirds of which is in cash. As you may recall from our prior call, we had taken a conservative approach to enhance our liquidity at the beginning of the COVID-19 outbreak by drawing in about $500 million of our revolvers. As a result of the strong collection we experienced in the quarter, we decided to pay back most of these facilities, lowering the overall interest expense for our businesses.

Next, I'd like to provide an update on our refinancing on slide 29. As you know, we have been proactively strengthening our debt maturity profile. Since last year, we executed more than $7 billion in liability management across our portfolio. In the second quarter alone, by taking advantage of a low interest rate environment, we refinanced more than $2 billion of debt, significantly reducing our interest costs, while eliminating any mature refinancing needs at both AES Corp. and DPL for the next five years.

Now to 2020 Parent capital allocation on slide 30. We expected $1.4 billion of discretionary cash this year, which is largely consistent with our previous disclosure. Regarding asset sales, we have already announced agreements to sell 2 gigawatt of coal generation, achieving roughly half of our target for 2020. We are working on a few other transactions and feel good about the prospect of achieving our targeted asset sales of $550 million for this year.

Moving to uses on the right-hand side. Including the 5% dividend increase we announced in December, we expected to return $381 million to shareholders this year. We plan to invest $700 million in our subsidiaries, 90% of which is in the US,

demonstrating our proactive actions to grow the portion of earnings coming from the US to about half by 2022. These investments include funding our renewables backlog, the equity for the Southland Repowering and the investment in rate-based growth at our utilities.

Regarding AES Gener, as Andrés mentioned, we are in negotiations to delink the PPAs from the coal assets and monetize the value of some of its storing agreement. As a result, we now expect the capital increase in our contribution of equity to happen in 2021. This leave us with up to $370 million to be allocated in 2020.

Next, moving to our capital allocation from 2020 through 2022, beginning on slide 31. We continue to expect our portfolio to generate $3.4 billion in discretionary cash. Three quarters of this is expected to be generated from Parent Free Cash Flow with the remaining $900 million coming from asset sale proceeds.

Turning to the uses of discretionary cash on slide 32. Roughly one-third will be allocated to shareholder dividends. Subject to annual review by the board, we continue to expect to increase the dividend by 4% to 6% per year, in line with the industry average. We're also expecting to use $1.9 billion to invest in our backlog, new projected PPAs, T&D investments at IPL, the partial funding of our Vietnam LNG project and the investment in AES Gener. This $1.9 billion also included the $300 million infrastructure investment in DP&L. Once completed, these projects will contribute to our growth through 2022 and beyond.

In summary, we are very encouraged by our solid financial performance today despite being in the middle of an unprecedented global crisis. Our performance and position validate the actions we have taken over the last several years to materially improve the quality and resilience of our business model and we remain very confident in our ability to continue delivering on our strategic and financial objectives.

With that, I'll turn the call back over to Andrés.

Andrés Gluski

Thank you, Gustavo. Before we take your questions, let me close today's call by saying that we remain very confident in achieving our guidance for 2020 and growth rates through 2022, attaining a second investment grade rating before year end, and realizing our decarbonization goals to meet Norges Bank's threshold by the end of the year. At the same time, we continue to make progress on deploying innovative technologies that we believe will give us a competitive edge in today's rapidly evolving and growing market.

With that, I would like to open up the call to your questions.

Q&A

Ahmed Pasha

Thank you. Thanks everybody for joining us on today's call. As always, the IR team will be available to answer any follow-up questions you may have. Thanks. Thanks again and have a nice day.